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MARCH 7, 1995

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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street NW, Room 222
Washington DC 20554

Re: Review of the Prime Time Access Rule, Section 73.658 (k) of the Commission's Rules (MM Docket No. 94-123)

Dear Mr. Caton:

Enclosed for filing in the record of the above proceeding are 10 copies of a study entitled "An Economic Analysis of the Prime Time Access Rule" which Economists Incorporated has prepared on behalf of Capital Cities/ABC, Inc., CBS Inc., and National Broadcasting Company, Inc.

Sincerely,

Enclosures

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
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In re:

Review of the Prime Time Access Rule, Section 73.658 (k) of the Commission's Rules	}	MM Docket No. 94-123

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AN ECONOMIC ANALYSIS OF THE PRIME TIME ACCESS RULE

March 7, 1995

ECONOMISTS INCORPORATED
WASHINGTON, D.C.

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I. INTRODUCTION

The Prime Time Access Rule (hereinafter PTAR or the Rule), by restricting the ability of ABC, CBS and NBC affiliates to broadcast successful programs during part of the day, was intended to increase the level of competition in program production by increasing the output of independent producers, to reduce network control over affiliates, to promote the growth of independent stations, and to increase diversity. Instead, PTAR has impeded competition and reduced viewer welfare.

For many years before adoption of the Rule in 1970, CBS and NBC had been the only significant broadcast networks. At the time of the Rule, ABC had only recently succeeded in achieving parity with CBS and NBC. The FCC's Prime Time Access Rule was a response to concerns that ABC, CBS and NBC dominated the program production market, controlled viewer choices, and fostered barriers to competing program sources.

An unstated but central element of the theory underlying PTAR is the notion that the success—whether measured in audiences or profits—of ABC, CBS and NBC was attributable to market failures or economic misbehavior. In fact, it is now understood that the success of broadcast networks—as opposed to non-network distributors or local producers—is attributable to economic characteristics of the marketplace that make network distribution more efficient. Further, the fact that there were in 1970 only three networks was chiefly the result of the Commission's own spectrum allocation policies. Nevertheless, in 1970 the Commission decided to achieve its public policy goals by handicapping its most successful broadcast licensees.

The Commission ordered ABC, CBS and NBC affiliates in the top-50 markets not to show network programming for more than three-quarters of the prime-time hours each day, resulting in withdrawal of all network programming in what became known as the "access period." Further, the Commission forbade ABC, CBS and NBC affiliates in the top-50 markets to broadcast off-network shows during the access period.[1] These provisions were intended to create opportunities for independent (and especially UHF) stations and for independent producers and syndicators.[2] The opportunities were created, of course, by denying television viewers the programs that had been provided by ABC, CBS, NBC and syndicators of off-network programs.

An analogy may be useful in understanding the theory of PTAR. It is as if the government had sought to deal with IBM's perceived dominance of mainframe computers in the 1970s by forbidding IBM to sell computers in 13 of the 50 states, and by forbidding also the sale of used IBM computers in those states. Such a remedy would make little sense, especially if IBM's dominance was attributable to superior products and better customer service. Further, the effect of the policy obviously would be to deny customers an option that they might have preferred. Finally, even if such a remedy could have been defended in the 1970s, it could hardly, in the case of IBM, be defended today, when IBM is beset by numerous energetic competitors.

The analogy with IBM suggests another feature of the PTAR debate. IBM, a single firm, apparently did "dominate" the market for mainframe computers, largely because of the superiority of its System 360 products.[3] ABC, CBS and NBC are not one firm, but three, and three keen rivals. Yet both the Commission and various commentators, simply by using the phrase "the

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1 The Rule appears at 47 C.F.R. §73.658(k) (1993). This summary of the Rule omits various details and exceptions. For purposes of this Report, the terms "access period" and "access hour" are used interchangeably to refer to 7–8 p.m. Eastern Time. Occasionally, where noted, "access period" is used to refer to the half hour from 7:30-8:00 p.m.

2 To the FCC in 1970, independent producers seems to have meant not merely producers, but also distributors, packagers and syndicators other than ABC, CBS and NBC—in short, non-network "sources."

3 *See generally*, GERALD W. BROCK, THE U.S. COMPUTER INDUSTRY: A STUDY OF MARKET POWER (1975).

networks" as one would use "IBM" in the analogy, imply that the three networks act as one—in respects relevant to the Rule. This tacit assumption cannot be accepted without proof, and no one has offered such proof. If the assumption is rejected, and if one then asks whether any of the *individual* firms, such as ABC, to whom the Rule is applied, *ever* had "dominance," the answer is that they did not.

Economic research in the twenty-five years since the Rule was adopted has shed considerable light on the premises and likely effects of the Rule. It is now clear, for example, that the Commission's own spectrum allocation policies (in conjunction with the economies of scale of television networking) limited the number of program choices and sources available to viewers in 1970.[4] At least with respect to prime-time entertainment programming, the viewing public appears to prefer high-quality, expensive productions that are broadcast nationwide to less expensive productions purchased or produced by local stations.[5] Expensive, high-quality programs can be supported only by distributors who can aggregate many viewers and corresponding advertising revenue. In a competitive struggle between national advertiser-supported network programming and locally produced or syndicated first-run programming, viewers' tastes and economies of scale are such that network programming will often do better than non-network programming.[6] It was such forces, rather than any economic or competi-

4 *See* THOMAS G. KRATTENMAKER & LUCAS A. POWE, JR., REGULATING BROADCAST PROGRAMMING 72-73, 287, 290 (1994); Krattenmaker, *The Prime Time Access Rule: Six Commandments for Inept Regulation,* 7 HASTINGS COMM. & ENT. L.J. 19 (1984); STANLEY M. BESEN, ET AL., MISREGULATING TELEVISION: NETWORK DOMINANCE AND THE FCC 37ff (1984); FCC, NETWORK INQUIRY SPECIAL STAFF, 1 NEW TELEVISION NETWORKS: ENTRY, JURISDICTION, OWNERSHIP, AND REGULATION 507-13 (1980) [hereinafter NISS].

5 The term "high-quality" with respect to television programs does not imply an aesthetic judgment. In this report "high-quality" is used synonymously with "expensive." Higher production expenses are incurred to increase the appeal of programming to potential viewers, and more popular programs tend to increase in cost as those involved in production accrue greater bargaining power. *See* BRUCE M. OWEN & STEVEN S. WILDMAN, VIDEO ECONOMICS 42ff (1992).

6 This outcome is not inevitable. If viewers preferred, for example, local-interest broadcast programming to national programming regardless of quality or expense,

tive pathology in the structure or behavior of the broadcast networks, that explained the relative success of ABC, CBS and NBC at the expense of locally produced or syndicated first-run programming.

Consequently, when the Commission adopted the Prime Time Access Rule, it constrained the television industry away from what was (given the spectrum allocated to broadcasting) the competitive equilibrium outcome. There is a general presumption that such policies reduce consumer welfare. In this case, theory predicts that the quality of programming available to the viewing public will decline, making viewers worse off. Conceivably, such a price might be worth paying if there were a more than compensating increase in diversity or other non-economic values. But in no way could or did PTAR increase the number of viewer choices available at any time, because the number of broadcast stations remained unaffected.

This report examines the following issues related to PTAR: (1) Are any of the original economic bases for the Rule valid today? For example, does ABC, CBS or NBC dominate the markets in which each operates? (2) What has been the effect of the Rule on competition, diversity and viewer welfare? The analysis and the empirical evidence lead to the conclusion that the Rule, if it was ever justified by economic conditions in this industry, is no longer justified. Further, the evidence is overwhelming that television viewers were from the beginning harmed by the Rule.

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the result would be local programming. In contrast, daily newspapers have substantial economies of scale and yet there are few national newspapers in this country and hundreds of local ones. This reflects readers' preference for local news content and a sufficiency of advertiser demand for local audiences.

II. Is ABC, CBS or NBC Dominant Today?

A. No single network dominates any market

Whether "dominance" refers to program selection and distribution or to program production, clearly none of the networks has ever enjoyed dominance. Even in the 1960s, when ABC, CBS and NBC each averaged about a third of national TV audiences and advertising revenues, the share of each network was less than what today would be regarded as the strictest antitrust standard for market dominance.[7] Even in the years immediately preceding the adoption of PTAR, no network had a share[8] of prime-time

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7 There is no single standard for market dominance in antitrust, even when there are barriers to entry. Learned Hand concluded that a 60 percent market share was insufficient to infer monopoly power. *United States v. Aluminium Co. of America*, 148 F.2d 416 (2d Cir. 1945). Various commentators concerned with dominant firms (as distinguished from monopolies) suggest market shares from 60 percent (Williamson) to 50 percent (Shepherd) to 40 percent (Stigler, Scherer, Pascoe, Weiss and Geroski). The 1992 DOJ/FTC HORIZONTAL MERGER GUIDELINES use a 35 percent threshold for purposes of defining a "leading firm," but only in a Clayton §7 context where the relevant standard is "incipiency," and even then only for purposes of identifying mergers that require closer scrutiny. Oliver E. Williamson, *Dominant Firms and the Monopoly Problem: Market Failure Considerations*, 85 HARVARD LAW REVIEW 1512-1531 (1972); William G. Shepherd, *Causes of Increased Competition in the U.S. Economy*, 1939-1980, 64 REVIEW OF ECONOMICS AND STATISTICS 613-626 (1982); George J. Stigler, *The Kinky Oligopoly Demand Curve and Rigid Prices*, 55 JOURNAL OF POLITICAL ECONOMY 432-449 (1947); F. M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE, 232 (2d ed. 1980); George Pascoe & Leonard W. Weiss, *The Extent and Permanence of Market Dominance* (1983) (FTC Bureau of Economics Working Paper); and P.A. Geroski, *Do Dominant Firms Decline?* in THE ECONOMICS OF MARKET DOMINANCE 143-167 Donald Hay & John Vickers, eds. (1987).

8 As used herein, when referring to audiences, "share" means television sets tuned to a particular station or network as a percentage of homes using television (HUTs) in a relevant geographic area. Shares can add to more than 100 percent because homes often have more than one switched-on set. "Rating" means television sets

television audiences that rose much above one-third, and each faced two rivals of almost equal size. The only way that ABC, CBS or NBC could ever have been perceived as having "dominance" was to assume that the networks were under unitary control or acted in concert. Such an assumption cannot be supported with any facts, and would run counter to the many manifestations of vigorous competition among the networks, particularly in their programming decisions.

The landscape of video distribution and production has been transformed completely since PTAR was established. This transformation includes the development of new television networks, the growth of independent television stations, and the explosion of programming delivered by cable and other distribution media. Because of these phenomena, ABC, CBS and NBC cannot be viewed as "dominant" today even if they were baselessly viewed as a single entity instead of three distinct, competing firms.

That no broadcast network has ever achieved "dominance" is due in part to the well-known rivalry among them. Though ABC, CBS and NBC have had similar audience shares, their rivalry for audiences and advertising dollars has caused a continual shifting of their relative positions. Figure 1 shows prime-time audience shares for the past 30 seasons. CBS had the largest share in the first part of this period, but led the other two networks by only 0.2 share points in 1964/65 and was virtually matched by NBC in 1968/69–1970/71. CBS had the largest share again until 1976/77, when it was overtaken by ABC. As recently as two years before taking the lead, ABC had the lowest share of the three networks. ABC maintained its lead for four seasons, after which CBS regained the lead for five seasons. Beginning in 1985/86, NBC had the highest share for six years. Recently, the lead has passed again to CBS. Such changes in relative position are not likely to have occurred if the networks were not competing intensely for audiences and advertising dollars.

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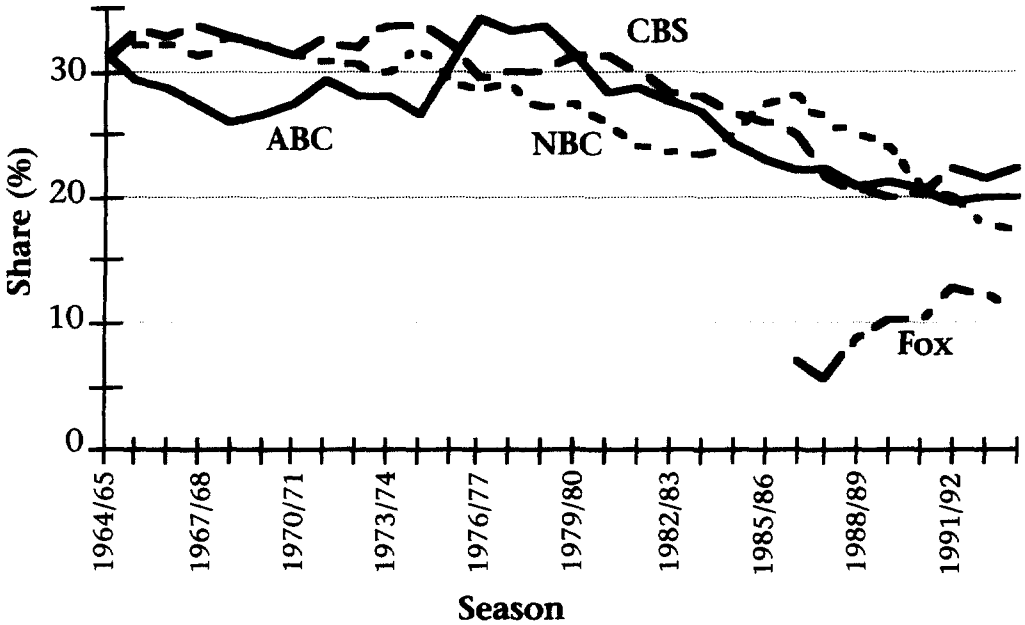
tuned to a particular station or network as a percentage of all television households (TVHHs), whether viewing or not, in a relevant geographic area.

Competition among ABC, CBS and NBC is further indicated by the quality and expense of their programming. As discussed below, programming expenditures by ABC, CBS and NBC per half-hour show are several times those of independent syndicators.

Figure 1 **Prime-time shares by season, 1964/65–1993/94**[9]



B. Factors facilitating the growth of competing video distributors

1. Cable penetration

Outlets for video programming grew chiefly because of the vast swelling in the number of cable subscribers. In 1970, fewer than 5 million households subscribed to cable television.[10] Up to that time, cable television was principally useful for improving the reception of broadcast television. The expanding availability of video programming from satellite-delivered cable networks considerably increased the appeal of cable television. After years

9 Source: Appendix A, Table A-1.

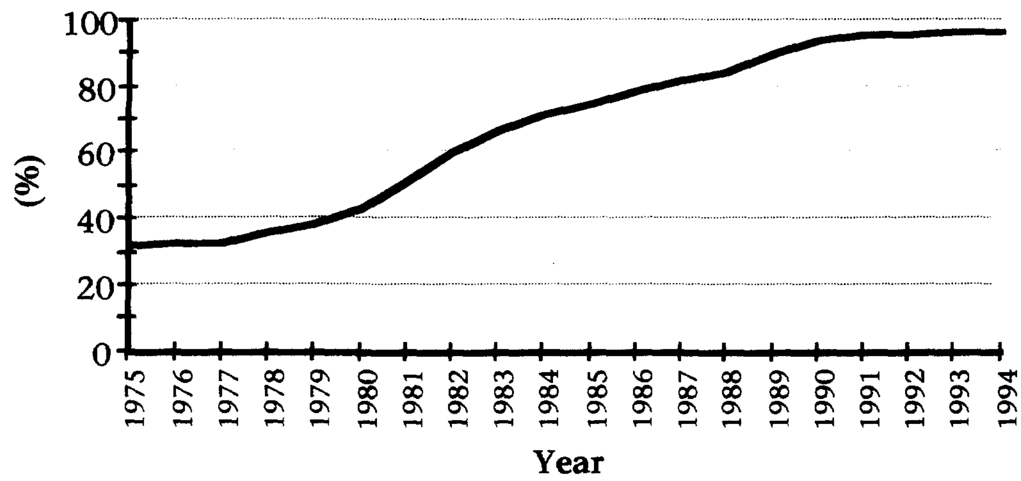
10 TELEVISION & CABLE FACTBOOK 1994, SERVICES at I-68.

of steady growth, approximately 59 million households subscribed to cable television in 1994.

These subscribers represent almost 62 percent of TV households (TVHH).[11] In no income class is penetration less than 50 percent, except for those with incomes under $10,000. Even for that group penetration is 46 percent.[12] Including households that are passed by cable but do not currently subscribe, over 91 million households, or 97 percent of television households, have *access* to video programming through cable television.[13] See Figure 2. Further, the number of cable channels available to subscribers has been growing. Today, 95 percent of cable subscribers receive 30 or more channels, and 38 percent receive 54 or more channels.[14]

Figure 2 Homes passed by cable[15]

(As a percentage of television households)



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11 *See* Appendix A, Table A-6.

12 According to Cabletelevision Advertising Bureau, penetration among households with incomes under $20,000 is 50.3 percent. Higher income classes have higher penetration. CAB computations based on NIELSEN TELEVISION INDEX, January 1995 and Mediamark Research Inc., Fall 1994 data.

13 *See By the Numbers*, BROADCASTING & CABLE, Jan. 9, 1995, at 61.

14 NATIONAL CABLE TELEVISION ASSOCIATION (NCTA), CABLE TELEVISION DEVELOPMENTS Fall 1994, 10-A.

15 Source: Appendix A, Table A-6.

Not only is cable programming widely available, it is heavily viewed by those households that choose to subscribe. In cable households, "basic" (advertiser- and cable operator-supported) and pay-cable networks have an all-week audience share of 49, greater than the sum of ABC, CBS and NBC affiliates' shares at 47.[16] Cable networks have a high audience share in cable households even in prime time. Their all-week prime-time share is 48, comparable to 53 for the combined share of ABC, CBS and NBC affiliates. See Table K-2. With such a wide variety of programming options available to and actively viewed by such a large portion of the nation, it would be ridiculous to assert that ABC, CBS and NBC "dominate" video programming even when taken together; the role played by each network is even more modest.

The growth of independent television stations referred to below is explained in significant part by their carriage on cable systems into an ever growing number of households. The rising number of subscribers to cable has also served to eliminate or reduce greatly the so-called "UHF handicap." This handicap refers to a disadvantage UHF independent stations have had in attracting a large audience in the past, principally due to the technical limitations television viewers have had in receiving over-the-air signals from UHF stations. Cable television, as well as other television delivery modes, greatly reduces or eliminates those technical limitations. See Appendix C.

2. Number and strength of independent stations

One of the most remarkable changes since PTAR was adopted has been the steady growth since 1980 in the number of independent commercial television stations, those not affiliated with ABC, CBS or NBC. In 1970, there were only 62 independent television stations in the United States.[17] See Figure 3. This number had increased by only 50 percent by 1978, but

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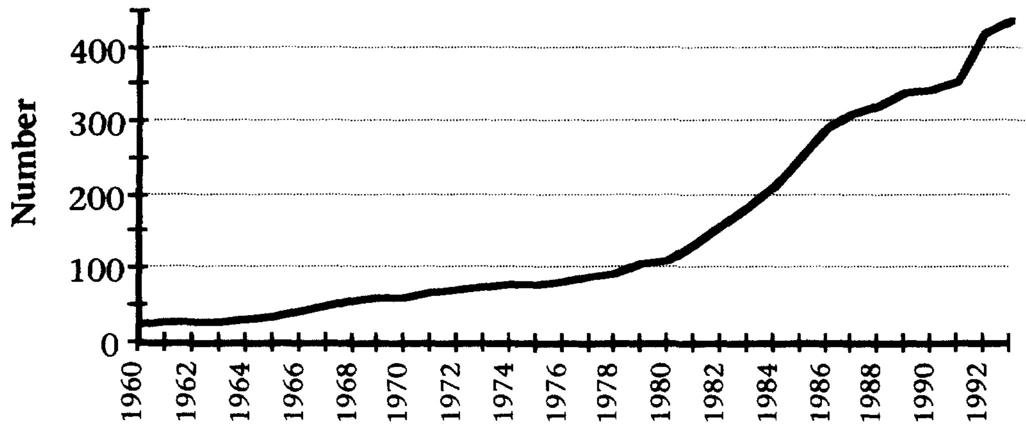
16 Based on NIELSEN TELEVISION INDEX. *See* Appendix K, Table K-1.

17 FCC, Notice of Proposed Rule Making, MM Docket 94-123, released Oct. 25, 1994 reports at ¶16 that there were 82 independent stations in 1970.

tripled to 186 stations by 1983. By 1993, the number had more than doubled again, reaching a total of 438. Now all top-50 markets are reached by Fox affiliates, and there is at least one non-Fox independent in all but one of the top-50 markets.[18] See Table 1. The average number of independent stations in the top-50 markets has increased from 1.3 per market in 1970 to 5.8 today.[19] To these independent stations should be added over 1,300 low-power television stations, most of which do not obtain programming from any of the broadcast networks. See Figure 4. Together, the increase in independent and low-power stations represents a huge increase in the demand for video programming.

Figure 3 U.S. independent commercial stations[20]



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18 The current 50 markets subject to PTAR restrictions were determined based on average prime-time audiences in February 1989 and February 1990. *See* FCC Public Notice, *Top 50 Markets for the Prime Time Access Rule, 1992-1995*, issued April 16, 1990. This report will use the term "top-50 markets" to refer to the "PTAR 50 markets," unless otherwise indicated.

19 FCC, Notice of Proposed Rule Making, *supra* note 17, ¶16.

20 Source: Appendix A, Table A-3.

Table 1 Fox and non-Fox independent stations in the top-50 markets[21]

Market	Fox			Non-Fox independent		
	VHF	UHF	Total	VHF	UHF	Total
Atlanta	1	0	1	0	6	6
Baltimore	0	1	1	0	2	2
Birmingham	1	0	1	0	2	2
Boston	0	1	1	0	8	8
Buffalo	0	1	1	0	1	1
Charleston-Huntington	1	0	1	0	1	1
Charlotte	0	1	1	0	2	2
Chicago	0	1	1	1	8	9
Cincinnati	0	1	1	0	1	1
Cleveland	1	0	1	0	7	7
Columbus, OH	0	1	1	0	2	2
Dallas-Ft. Worth	1	0	1	0	10	10
Denver	0	1	1	1	6	7
Detroit	1	0	1	0	4	4
Grand Rapids-Kal'mzoo-B.Crk	0	1	1	0	2	2
Greensboro-H.Point-W. Salem	1	0	1	0	4	4
Greenv'll.-Spart.-Ashevll-And	0	1	1	0	2	2
Harrisburg-Lncstr-Leb-York	0	1	1	0	2	2
Hartford & New Haven	0	1	1	0	2	2
Houston	0	1	1	0	9	9
Indianapolis	0	1	1	1	5	6
Kansas City	1	0	1	0	3	3
Little Rock-Pine Bluff	0	1	1	0	3	3
Los Angeles	1	0	1	3	10	13
Louisville	0	1	1	0	1	1
Memphis	1	0	1	0	3	3
Miami-Ft. Lauderdale	1	0	1	0	8	8
Milwaukee	1	0	1	0	5	5
Minneapolis-St. Paul	0	1	1	1	2	3
Nashville	0	1	1	0	4	4
New Orleans	1	0	1	0	2	2
New York	1	0	1	2	8	10
Norfolk-Portsmth-Newpt Nws	0	1	1	0	3	3
Oklahoma City	0	1	1	0	3	3
Orlando-Daytona Bch-Melbrn	0	1	1	0	5	5
Philadelphia	0	1	1	0	8	8
Phoenix	1	0	1	4	4	8
Pittsburgh	0	1	1	0	3	3
Portland, OR	0	1	1	1	2	3
Providence-New Bedford	0	1	1	0	0	0
Raleigh-Durham	0	1	1	0	4	4
Sacramnto-Stkton-Modesto	0	1	1	0	5	5
Salt Lake City	1	0	1	0	2	2
San Antonio	0	1	1	0	5	5
San Diego*	1	0	1	0	2	2
San Francisco-Oak-San Jose	1	0	1	0	11	11
Seattle-Tacoma	1	0	1	2	4	6
St. Louis	1	0	1	1	2	3
Tampa-St. Petersburg	1	0	1	0	5	5
Washington, D.C.	1	0	1	0	6	6
Total	22	28	50	17	209	226

*San Diego receives Fox from XETV, a station broadcasting from Tijuana, Mexico.

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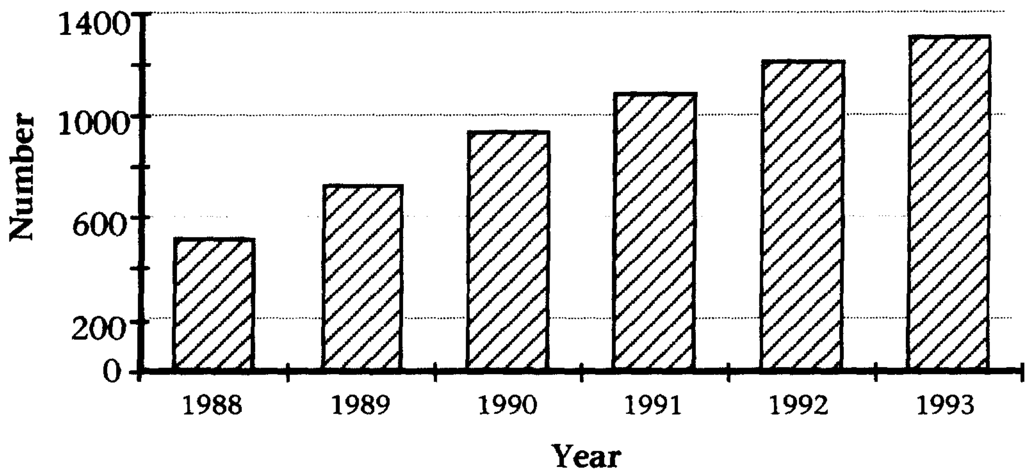
21 Source: NIELSEN STATION INDEX, 1993, updated from BROADCASTING & CABLE, Dec. 5, 1994, at 50-56.

Figure 4 Low-power television stations in the U.S.[22]



3. Other video outlets

Though large, the numbers of cable subscribers and homes passed by cable understate the availability of video programming by means other than broadcast television. About 2.1 million households subscribed to video services through backyard dishes at the end of 1994, and even more receive non-subscription services such as shopping and religious channels by this means. SMATV serves another 1.1 million subscribing households, and another 600,000 households subscribe to wireless cable (MMDS). See Figure 5. Service from direct broadcast satellite systems (DBS) is now well underway, with service provided today by DirecTV, USSB and PrimeStar, with others planning to launch.

Like cable, DBS is ubiquitous, offering an alternative to virtually every household, whether or not it subscribes. Many sources estimate that DBS subscribers will exceed 1 million in 1995, and may exceed 10 million by 2000.[23] This growth is significant not only because it will expand the number of households obtaining video programming from a source other than ABC, CBS or NBC, but also because the large channel capacity on DBS

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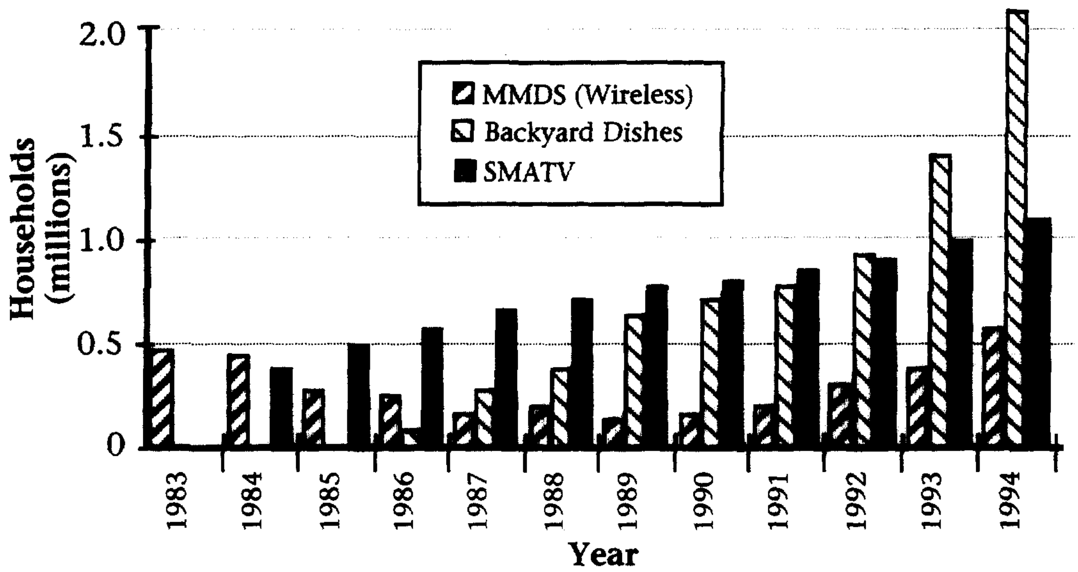
22 Source: Appendix A, Table A-4. Low-power television service was established March 4, 1982.

23 *See*, for example, *DBS Disagreements Emerge,* CABLEVISION, Nov. 14, 1994, at 6.

services will create demand for still more video programming.[24] A similar expansion of video channels will likely result from video dial tone (VDT) offerings now in pilot stages with six of the seven RBOCs as well as GTE and a number of other independent telephone companies.

Figure 5 **Households subscribing to video programming via backyard dishes, SMATV and MMDS[25]**



The growth in these video outlets, together with increases in independent stations and cable penetration, has enhanced the potential for new broadcast networks, increased the demand for video programming, and increased the competition for viewers among video media.

C. Competing video distributors

1. New broadcast networks

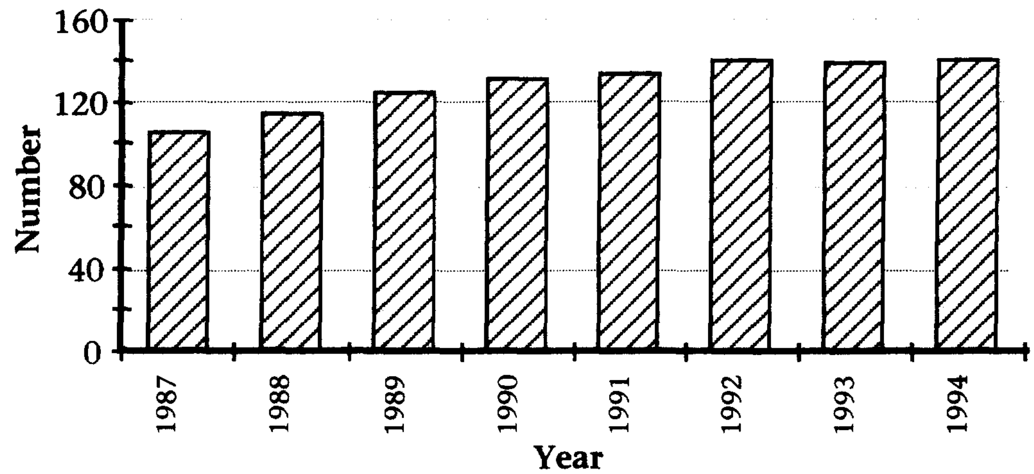
The remarkable growth in the number of video outlets has been matched by a mushrooming of new video distributors, including new broadcast net-

24 For example, DBS service providers expect to obtain programming from producers not now selling to cable or television networks. *See DBS Systems Expected to Seek New Programming Sources*, SATELLITE WEEK, Sept. 26, 1994.

25 Source: Appendix A, Table A-7.

works. The first of these new networks,[26] Fox Broadcasting Company, began supplying network programming during prime time in April 1987, programming a single night aired by over 100 affiliated stations.[27] Figure 6 shows the growth of Fox affiliated stations. By the 1989 season, Fox was offering three nights of programming through 125 affiliates. Fox began programming prime time every night of the week in 1993. It currently programs 15 hours of prime time per week, and 29 hours per week overall, excluding football. Its affiliate count has grown to 199 stations, including those with secondary affiliation.[28] All top-50 markets are reached by Fox affiliates. Fox currently reaches 98.7 percent of the national audience.[29]

Figure 6 Fox affiliates[30]



Fox competes with ABC, CBS and NBC to acquire programming, to attract audiences, and to sell advertising time. Fox also competes to attract and re-

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26 Fox has all of the economic characteristics of a network, even though it is not considered a network under the Commission's PTAR definition.

27 Sources for this paragraph: *The Fox Trots Faster*, TIME, Aug. 27, 1990, at 64; *Fox TV 'no longer a weblet,'* TELEVISION DIGEST, July 19, 1993, at 5; BROADCASTING & CABLE MARKETPLACE 1992, at lxix; and Table 1.

28 A secondary affiliate is a station that broadcasts primarily the programming of one network but also broadcasts part or all of another network's offerings.

29 ELECTRONIC MEDIA, Dec. 19-26, 1994, at 55.

30 Source: Appendix A, Table A-2.